KARYA LAGENDA SDN BHD

v.

KEJURUTERAAN BINTAI KINDENKO SDN BHD & ANOR

COURT OF APPEAL, PUTRAJAYA
GOPAL SRI RAM JCA
ZULKEFLI MAKINUDIN JCA
RAUS SHARIF JCA
[CIVIL APPEAL NO: W-02-1184-2005]
16 JULY 2007

BANKING: *Securities for advances - Guarantee given by bank - Demand for payment - Whether valid - Performance bond - Conditional or unconditional - Mutual determination of building contract - Whether original bank guarantee must be presented at time of demand*

CONTRACT: *Guarantee - Banker's guarantee - Demand for payment - Whether valid - Performance bond - Conditional or unconditional - Mutual determination of building contract - Whether original bank guarantee must be presented at time of demand*

This was an appeal by the first defendant against the decision of the High Court ordering, in an interpleader proceeding, that a judgment be entered against the plaintiff in favour of the second defendant for the sum of RM2,075,700.94 with costs to be borne by the first defendant. The second defendant, the main contractor for a project known as Sri Rampai Project ('project'), had engaged the first defendant to be the sub-contractor for the project. The plaintiff, at the request of the first defendant, issued a bank guarantee dated 27 June 2003 for the sum of RM2,075,700.94 ('bank guarantee') in favour of the second defendant. The bank guarantee was arranged for by the first defendant as required in the building contract between the first and second defendant. Disputes subsequently arose between the first and second defendant in the performance of the building contract, and the second defendant made a demand on the bank guarantee. As the first defendant challenged the validity of the demand, the plaintiff did not make any payment to the second defendant. The first defendant then demanded the release of its fixed deposit funds – secured for the granting of the bank guarantee – to which the

plaintiff did not accede. The plaintiff commenced an interpleader proceeding in the High Court to determine whether, *inter alia*, there was liability to pay on the bank guarantee. The first defendant in turn counterclaimed against the plaintiff for the release its fixed deposit funds. The High Court decided in favour of the second defendant and dismissed the first defendant's counterclaim, resulting in the present appeal. Since the main question in this appeal concerned the validity of the second defendant's demand for payment of the bank guarantee, the issues in this appeal requiring determination were: (i) whether the bank guarantee was conditional or unconditional; (ii) whether there was mutual determination of the building contract; and (iii) whether the original bank guarantee must be presented at the time of demand before payment could be made.

Held (dismissing the appeal)
Per Raus Sharif JCA delivering the judgment of the court:

(1) The bank guarantee was a performance bond. Whether a performance bond is conditional or unconditional must depend on the terms of the bond itself. In the present case, the relevant clause of the bank guarantee clearly indicated that the bank guarantee was an unconditional and "on demand" bank guarantee. Payment should therefore be effected by the plaintiff when a valid demand was made by the second defendant, notwithstanding any contestation by the first defendant or the plaintiff. There was no dispute that several demands were made by the second defendant, claiming from the plaintiff the full sum of the bank guarantee amounting to RM2,075,700.94 due to non-performance of the building contract. Since the bank guarantee was an unconditional and "on demand" bank guarantee, there was no necessity for the demand letter, as contended by the first defendant, to expressly assert that the first defendant had failed to perform or had breached the underlying building contract. (Paras 9, 10 & 11)

(2) Although there were discussions and negotiations between the first and second defendant, there was no mutual determination of the building contract. In any event, the bank guarantee to which the plaintiff and the second defendant were parties was a distinct legal document from the building contract, which

was an agreement between the first and second defendant. The building contract formed no part of the bank guarantee. The bank guarantee by its terms was an unconditional and a pure "on demand" guarantee. All that was required to activate it was a written demand by the second defendant. (para 13)

(3) The failure to present the original bank guarantee at the time of demand was a non-issue. The payment mechanism as contained in the bank guarantee made no reference to any requirement that the original bank guarantee must be produced at the time of demand before payment could be made. In this case, it was not a contractual requirement that must be complied with. (para 14)

Bahasa Malaysia *Translation Of Headnotes*

Ini adalah rayuan defendan pertama terhadap keputusan Mahkamah Tinggi kerana memerintahkan, dalam satu prosiding interplider, bahawa penghakiman sebanyak RM2,075,700.94 hendaklah dimasukkan terhadap plaintif untuk manfaat defendan kedua dengan kos ditanggung oleh defendan pertama. Defendan kedua, kontraktor utama bagi projek yang dikenali sebagai projek Sri Rampai ('projek'), telah melantik defendan pertama sebagai sub-kontraktor untuk projek. Atas permintaan defendan pertama, plaintif mengeluarkan satu bank gerenti untuk jumlah RM2,075,700.94 bertarikh 27 Jun 2003 ('bank gerenti') untuk manfaat defendan kedua. Bank gerenti dipohon defendan pertama selaras dengan kehendak kontrak bangunan di antaranya dengan defendan kedua. Salah faham timbul di antara defendan pertama dan kedua mengenai pelaksanaan kontrak bangunan, dan defendan kedua membuat tuntutan ke atas bank gerenti. Oleh kerana kesahan tuntutan tersebut dicabar oleh defendan pertama, maka plaintif tidak membuat sebarang bayaran kepada defendan kedua. Defendan pertama kemudian menuntut pelepasan simpanan tetapnya – yang menjadi jaminan kepada bank gerenti – tetapi tuntutan tersebut tidak dilayan oleh plaintif. Seterusnya, plaintif memulakan prosiding interplider di Mahkamah Tinggi, antara lain bagi memutuskan sama ada ia berliabiliti untuk membayar atas bank gerenti. Di sebalik itu, defendan pertama membuat tuntutan balas terhadap plaintif untuk melepaskan simpanan tetapnya. Mahkamah Tinggi memutuskan dengan berpihak kepada defendan

kedua dan menolak tuntutan balas defendan pertama, sekaligus mencetuskan rayuan di sini. Oleh kerana persoalan utama di dalam rayuan ini menyentuhi kesahan tuntutan defendan kedua untuk pembayaran bank gerenti, maka isu-isu berikut berbangkit untuk pemutusan, iaitu: (i) sama ada bank gerenti satu bank gerenti bersyarat atau tidak bersyarat; (ii) sama ada kontrak bangunan ditamatkan secara mutual; dan (iii) sama ada bank gerenti asal perlu dikemukakan semasa membuat tuntutan sebelum pembayaran ke atasnya boleh dibuat.

Diputuskan (menolak rayuan)
Oleh Raus Sharif HMR menyampaikan penghakiman mahkamah:

(1) Bank gerenti adalah satu bon pelaksanaan. Sama ada suatu bon pelaksanaan adalah bersyarat atau tidak bersyarat adalah bergantung kepada terma-terma bon itu sendiri. Dalam kes semasa, klausa relevan menunjukkan dengan jelas bahawa bank gerenti adalah "atas tuntutan" dan tak bersyarat. Pembayaran dengan itu harus dibuat oleh plaintif sebaik sahaja suatu tuntutan yang sah dibuat oleh defendan kedua, walaupun terdapat bantahan oleh defendan pertama mahupun plaintif. Tidak dinafikan bahawa terdapat beberapa tuntutan dibuat oleh defendan kedua, menuntut dari plaintif jumlah penuh bank gerenti sebanyak RM2,075,700.94 yang menjadi terbayar ekoran ketidak-laksanaan kontrak bangunan. Oleh kerana bank gerenti merupakan bank gerenti "atas tuntutan" dan tidak bersyarat, tidaklah perlu bagi surat tuntutan menyatakan secara ekspres bahawa defendan pertama gagal melaksanakan ataupun telah melanggar kontrak bangunan seperti yang dihujahkan oleh defendan pertama.

(2) Walaupun terdapat perundingan di antara defendan pertama dan kedua, penamatan secara mutual kontrak bangunan tidak berlaku. Apapun, bank gerenti kepada mana plaintif dan defendan kedua menjadi pihak, adalah suatu dokumen undang-undang yang asing dari kontrak bangunan yang merupakan perjanjian di antara defendan pertama dan kedua. Kontrak bangunan bukan merupakan sebahagian dari bank gerenti. Atas terma-termanya, bank gerenti adalah satu gerenti "atas

tuntutan" tulen dan tak bersyarat. Yang perlu bagi mengaktifkannya hanyalah satu surat tuntutan dari defendan kedua.

(3) Kegagalan menyerahkan bank gerenti asal semasa membuat tuntutan adalah satu non-issue. Mekanisma bayaran sebagaimana yang diperuntukkan oleh bank gerenti tidak menyebut tentang keperluan mengemukakan bank gerenti asal semasa membuat tuntutan bagi membolehkan pembayaran dibuat. Dalam kes ini, ia bukan satu keperluan kontrak yang mesti dipatuhi.

Case(s) referred to:

Cygal Bhd v. Bandar Subang Sdn Bhd [2004] 3 CLJ 67 CA ***(refd)***

Hermis Interco BV Sdn Bhd v. Syarikat Pembinaan Hashnudin Sdn Bhd [1986] 1 MLJ 245 ***(refd)***

HSH Engineering & Construction Sdn Bhd v. Belton Properties Sdn Bhd & Anor [2001] 2 CLJ 186 HC ***(refd)***

LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor [2000] 3 CLJ 473 CA ***(refd)***

Syarikat Perumahan Pegawai Kerajaan Sdn Bhd v. Bank Bumiputra Malaysia Bhd [1990] 2 CLJ 1052; [1990] 3 CLJ (Rep) 159 HC ***(refd)***

Teknik Cekap Sdn Bhd v. Public Bank Bhd [1995] 4 CLJ 697 CA ***(refd)***

For the appellant - Chen Mian Kuang; M/s MK Chen & Leong
For the 1st respondent - Rodney Gomez; M/s Shearn Delamore & Co
For the 2nd respondent - K Ganesan (Satrinder Kaur with him); M/s Muhammad Ganesan & Nazri

[Appeal from High Court, Kuala Lumpur; Originating Summons No: D5-24-165-2005]

Reported by Suresh Nathan

JUDGMENT

Raus Sharif JCA:

[1] This is an appeal by the first defendant against the judgment of the High Court, Kuala Lumpur, ordering in an interpleader proceedings, a judgment be entered against the plaintiff in favour of the second defendant for the sum RM2,075,700.94 with costs to be borne by the first defendant.

[2] The facts of this case are these. The second defendant was the main contractor for Sri Rampai project ("the project"). The first defendant was the sub-contractor engaged by the second defendant for the project. At the request of the first defendant the plaintiff issued a Bankers Guarantee No. TF001G784990 dated 27 June 2003 ("bank guarantee") for the sum of RM2,075,700.94 in favour of the second defendant. The bank guarantee was arranged for by the first defendant as required in the building contract between the first and second defendant.

[3] Disputes arose between the first and second defendant in the performance of the building contract. The second defendant alleged that the works were not completed on time by the first defendant as stipulated in the building contract even after an extension of time was granted by the second defendant.

[4] Subsequently, the second defendant made a demand on the bank guarantee. The first defendant challenged the validity of the demand. Hence, no payment was made to the second defendant by the plaintiff. The first defendant than demanded for the release of the fixed deposit funds, secured for the granting of the bank guarantee. The plaintiff did not accede to the same.

[5] On 13 May 2005, the plaintiff commenced an interpleader proceeding in the High Court to determine the question whether, *inter alia*, there is liability to pay on the bank guarantee. The first defendant in turn made a counterclaim against the plaintiff for the release of the first defendant's fixed deposit funds. On 24 October 2005, the High Court decided in favour of the second defendant. The first defendant's counterclaim was accordingly dismissed. Hence, this appeal.

[6] The main question before the High Court as well as before this court was whether the second defendant's demand was valid to trigger payment of the bank guarantee. The issue as to the release of the fixed deposit funds would hinge on the outcome of the main question. If the plaintiff did not have to pay out of the bank guarantee, the plaintiff has to release the fixed deposit funds to the first defendant.

[7] It is the first defendant's case that the second defendant's demand was invalid. The reasons were:

(i) it failed to clearly and expressly assert that the first defendant had failed to perform or breached the underlying building contract;

(ii) by the time the second defendant made the demand, the building contract had been mutually terminated and there can therefore be no breach of contract to trigger payment under the bank guarantee;

(iii) the second defendant had failed to present the original bank guarantee to the plaintiff together with its demand.

[8] The second defendant responded by stating:

(i) the bank guarantee is an unconditional and "on demand" bank guarantee. Payment therefore must be effected by the plaintiff when a valid demand on the bank guarantee is made;

(ii) there was no mutual determination of the building contract. There were discussions and negotiations entered into between the first defendant and second defendant, but the same was unsuccessful. Even if there was a mutual agreement (which was strongly denied by the second defendant) the first defendant is still not absolved of its liability under the bank guarantee.

(iii) The bank guarantee made no reference or requirement that the original bank guarantee must be produced at the time of the demand before payment can be made.

(i) Whether The Bank Guarantee Was Conditional Or Unconditional

[9] The learned High Court Judge ruled that the bank guarantee dated 27 June 2003 issued by the plaintiff in favour of the second defendant is an unconditional guarantee or "on demand bond" and all that is required to activate it is a written demand by the second defendant. The learned High Court Judge rejected the argument of the necessity for the second defendant to prove default on the part of the first defendant in performance of the building contract. We are in agreement with the learned High Court Judge. It is our judgment that the bank guarantee is a performance bond. Whether a performance bond is conditional or unconditional must depend on the terms of the bond itself (*Teknik Cekap Sdn. Bhd. v. Public Bank Berhad* [1995] 4 CLJ 697). In the present case, the relevant clause of the bank guarantee read as follows:

> *If the contractor,* unless relieved from the performance by any clause of the contract or by statute or by the decision of a tribunal of competence jurisdiction, *shall in any respect fail to perform under the contract or commit any breach of his obligation there under, then the guarantor shall pay to the principal* up to a total aggregate sum not exceeding the amount of RINGGIT MALAYSIA TWO MILLION SEVENTY FIVE THOUSAND SEVEN HUNDRED AND SEN NINETY FOUR ONLY (RM2,075,700.94) *on the principal's demand notwithstanding any contestation of protest by the contractor or by the guarantor or by any third party,* provided always that the total of all partial demands so made shall not exceed the aggregate sum of RINGGIT MALAYSIA TWO MILLION SEVENTY FIVE THOUSAND SEVEN HUNDRED AND SEN NINETY FOUR ONLY (RM2,075,700.94) and the guarantor's liability to pay the principal as aforesaid shall correspondingly be reduced proportionate to any partial demand having been made as aforesaid. (emphasis added)

[10] It is our judgment the above clause is a clear indication that the bank guarantee is an unconditional and "on demand" bank guarantee. Payment should therefore be effected by the plaintiff notwithstanding any contestation by the first defendant or the plaintiff when a valid demand is made by the second defendant. In this case there is no dispute that several demands were made by the second defendant, claiming from the plaintiff for the full sum of the bank guarantee amounting to RM2,075,700.94 due to non-performance of the building contract.

[11] We are of the view, since the bank guarantee was an unconditional and "on demand" bank guarantee, there is no necessity for the demand letter as contended by the first defendant to expressly assert that the first defendant had failed to perform or breached the underlying building contract. Hence, the High Court Judge's finding on this issue is not erroneous.

[12] In fact the wording of the bank guarantee in the present case is identical to the wording of performance bonds/bank guarantees that have come before the courts. (*Syarikat Perumahan Pegawai Kerajaan Sdn. Bhd. v Bank Bumiputra Malaysia Bhd.* [1990] 2 CLJ 1052; [1990] 3 CLJ (Rep) 159, *Cygal Bhd. v. Bandar Subang Sdn. Bhd.* [2004] 3 CLJ 67, *Hermis Interco BV Sdn. Bhd. v. Syarikat Pembinaan Hashnudin Sdn. Bhd.* [1986] 1 MLJ 245, *HSH Engineering & Construction Sdn Bhd v. Belton Properties Sdn. Bhd. &*

Anor [2001] 2 CLJ 186 and *LEC Contractors (M) Sdn. Bhd. v. Castle Inn Sdn Bhd & Anor* [2000] 3 CLJ 473). In all these cases the courts have consistently held that such guarantee/bond is an 'unconditional bond' or an 'on demand bond'. We have no reason to interpret differently.

(ii) Mutual Determination Of The Contract

[13] The learned High Court Judge agreed with the second defendant that although there were discussions and negotiations between the first and second defendant there was no mutual determination of the building contract. He also ruled that even if there was a mutual determination of the building contract, first defendant is still not absolved of the liability of the bank guarantee. Again, we are in agreement with the learned High Court Judge. There was no mutual determination of the building contract. In any event, it is our judgment that the bank guarantee to which the plaintiff and second defendant are a party to, is a distinct legal document from the building contract, which is an agreement between the first defendant and second defendant. The building contract forms no part of the bank guarantee. The bank guarantee by its terms as stated earlier is unconditional and a pure on-demand guarantee. All that is required to activate it is a written demand by the second defendant.

(iii) Failure To Present The Original Bank Guarantee At The Time Of Demand

[14] It is our judgment this issue has no bearing in the present case. The payment mechanism as contained in the bank guarantee make no reference or requirement that the original bank guarantee must be produced at the time of demand before payment can be made. It is not a contractual requirement which must be complied with in this case. To us this is a non-issue.

[15] For the above reasons, we unanimously dismissed the appeal and the usual orders consequential on dismissal were made.